Agenda Date: 10/30/02
Agenda Item: 2I

STATE OF NEW JERSEY
Board of Public Utilities
Two Gateway Center
Newark, NJ 07102
www.bpu.state.nj.us

<u>ENERGY</u>

IN THE MATTER OF THE REQUEST FOR BOARD AUTHORIZATION OF A TEN-MONTH EXTENSION OF NEW JERSEY NATURAL GAS COMPANY'S EXISITNG INCENTIVE MECHANISMS THROUGH OCTOBER 31, 2003	)))))	ORDER AUTHORIZING EXTENSION OF INCENTIVE PROGRAMS DOCKET NO.GO02100731

(SERVICE LIST ATTACHED)

BY THE BOARD**:**

Pursuant to the Electric Discount and Energy Competition Act ("EDECA"), <u>N.J.S.A.</u> 48:3-49 <u>et</u>. <u>seq</u>., New Jersey Natural Gas Company ("NJNG" or the "Company") offers to all of its customers the option of purchasing Basic Gas Supply Service ("BGSS") from the Company. NJNG procures the portfolio of pipeline storage and supply resources necessary to satisfy its obligation to provide safe and reliable BGSS. As the natural gas marketplace has evolved, the Board of Public Utilities ("Board") has approved incentive-based mechanisms, which were developed and agreed to by the parties to various proceedings. The incentive based mechanisms which are the subject of this Order are: 1) Off System-Sales and Capacity Release; 2) Financial Risk Management Program; 3) Capacity Reduction and Portfolio Enhancement; and 4) the Market Development Fund ("MDF"). These programs are briefly described below.

<u>1) Off-System Sales and Capacity Release Margin Sharing</u>

The off-system sales and capacity release programs were first implemented in 1992. These programs provide incentives for NJNG to generate incremental margin through the utilization of capacity when firm on-system customers do not need it, such as during periods of warm weather. With the implementation of these programs, NJNG has invested in additional systems and processes and enhanced the sophistication of its Energy Services business unit to maximize the benefits that could be achieved in the changing wholesale marketplace. The existing sharing formula, which has been in place since 1998, provides 85% of all margins to customers and 15% to the Company.[1]

2) Financial Risk Management

The financial risk management program was implemented on a pilot basis in 1994 and expanded in 1996 to promote the use of financial risk management tools. The sharing formula for this incentive has been 80% to the customers and 20% to the Company.

3) Capacity Reduction and Portfolio Enhancement

The capacity reduction and portfolio enhancement program was implemented in 1998 to encourage activities by NJNG to reshape its existing portfolio of resources in a manner that would reduce the unit costs of capacity and better fit the changing needs of customers. The benefits associated with each qualifying transaction are shared 60% by customers and 40% by NJNG for the first twelve months and 85% by customers and 15% by the Company thereafter.

4) Market Development Fund

The purpose of this fund is to promote third-party supplier activity in NJNG's service territory through the payment of incentives to customers who purchase their supply from a third-party supplier. The incentives are funded through the MDF established by the Board in Docket No. GO99030123. No monies from the MDF are paid to the Company.

These incentive mechanisms incorporate defined expiration dates to ensure that the parties revisit the appropriateness of continuing the programs in their current form on a periodic basis. The above listed mechanisms are slated to expire on December 31, 2002. NJNG, the Staff of the Board ("Staff") and the Division of Ratepayer Advocate ("Ratepayer Advocate") (collectively "the parties") have been discussing whether the incentive based programs should continue and, if so, in what form. At this time, the parties have not reached final agreement on these issues.

On September 30, 2002, NJNG submitted a letter to the Board, on behalf of the parties. The purpose of the letter was to request Board authorization of a 10-month extension of the above listed incentive mechanisms through October 31, 2003, with one modification. Specifically, the existing margin sharing formulae for the capacity reduction and portfolio enhancement transactions provide for future ongoing sharing based on historic formulae currently in place. The proposed modification calls for margin sharing during the 10-month extension through October 31, 2003 to include the existing sharing related to all

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1 While off-system sales and capacity release constitute the majority of margins subject to various margin sharing formulae, margins associated with on-system sales and transportation services and sales to Sayreville and Forked River electric generation plants are also shared. The sharing formulae for these transactions are as follows: for interruptible sales, 90% to customers and 10% to the Company; for interruptible transportation, 95% customers and 5% to the Company after an initial 5% is credited to the MDF; and for sales to the electric generation plants, 90% to customers and 10% to the Company after an initial contribution of $0.01 per therm to customers.

transactions that were consummated on or before December 31, 2002, but not to include sharing related to transactions that were consummated after December 31, 2002. Thus, 100% of the benefits associated with transactions consummated after December 31, 2002, if any, would go to customers. With this exception, the proposed extension would preserve the *status quo* for a 10-month period. Further, it is anticipated that the extension will terminate at approximately the same time as new rates are expected to be established in NJNG's current BGSS filing which was made on October 17, 2002.

Staff and the Ratepayer Advocate support the instant request to extend the existing mechanisms for a period of 10 months, since it would give the parties additional time to consider whether modification to or elimination of these incentive programs are appropriate based upon conditions in the natural gas marketplace.

Accordingly, the parties have requested that the Board extend the following incentive programs through October 31, 2003:

(1) The Company's margin sharing formulae associated with capacity release, off-system sales, on-system non-firm sales and transportation as approved by the Board in BPU Docket Nos. GR97070542, et al.,

(2) The Company's margin sharing formulae associated with capacity reductions and portfolio enhancements as approved by the Board in BPU Docket Nos. GR97070542, et al., subject to the modification discussed above.

(3) The Company's financial risk management program as approved by the Board in BPU Docket Nos. GR96070551, et al., and

(4) The Company's MDF mechanism to provide incentives for customers to purchase supply from competitive suppliers as approved by the Board in BPU Docket No. GO99030123.

Discussion and Findings

The Board, having reviewed the request of the parties, FINDS that there is good cause to approve this extension since it will allow the parties to continue ongoing discussions with the goal of bringing to the Board a proposed resolution of future incentives for its consideration. Further, this extension will also allow the parties to consider these issues contemporaneously with any changes to the BGSS structure, which are being discussed concurrently.

Accordingly, the Board HEREBY APPROVES the request for a 10-month extension of the above-described incentive mechanisms with the modification discussed herein, through October 31, 2003.

DATED: 10/31/02

BOARD OF PUBLIC UTILITIES
BY:

(SIGNED)
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PRESIDENT

(SIGNED)
FREDERICK F. BUTLER
COMMISSIONER

(SIGNED)
CAROL J. MURPHY
COMMISSIONER

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CONNIE O. HUGHES
COMMISSIONER

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JACK ALTER
ACTING COMMISSIONER

ATTEST:

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KRISTI IZZO
SECRETARY

New Jersey Natural Gas Company
Request for Authorization to Extend Incentive Programs
BPU Docket No. GO02100731
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Background on Existing Programs

The existing incentive mechanisms are comprised of (1) various margin sharing programs including off-system sales and capacity release, (2) capacity reduction and portfolio enhancement and (3) financial risk management incentives. The various incentive mechanisms have been designed and implemented over time to maximize benefits for customers by promoting the deployment of appropriate resources and the implementation of beneficial gas supply purchasing and asset management strategies. The primary benefits of the incentive mechanisms are reduced costs for consumers without compromising reliability. The mechanisms have been designed to be consistent with NJNG's responsibilities to provide gas supply service to its customers as well as to support the policy goals of promoting the development of competitive retail markets. In addition to these incentive mechanisms, NJNG also provides an incentive to customers who purchase supply from third-parties which is funded through the Company's Market Development Fund ("MDF").

Pursuant to EDECA, BGSS is a fully-regulated service that is made available to all customers, regardless of their ability to obtain supply from third-party suppliers or to pay for service. Further, EDECA provided that the utility would be the BGSS provider during the initial transition to competition and until such time as the Board makes a finding that others could provide BGSS in addition to the utility. In essence, EDECA requires the utility to serve as provider-of-last-resort for all retail customers regardless of the status of competitive activity in the marketplace.

In general, at the time of the initial rate unbundling pursuant to EDECA, the existing programs were extended through the end of the originally contemplated transition period of December 31, 2002. The transition to competition has been slower than anticipated and NJNG continues to provide BGSS to a large number of its customers, especially residential and smaller commercial customers. More recently, the Board has determined that it is not ready to permit parties other than the utility to provide BGSS further extending NJNG's BGSS role beyond December 31, 2002[2]

Status of Discussions

With the anticipated expiration of the existing incentive mechanisms, NJNG initiated discussions with the Board Staff and the Ratepayer Advocate to discuss the design of appropriate incentives beyond 2002. Among the matters discussed at these meetings has been the potential continuation of the existing mechanisms in some manner as well as the possibility of creating new types of programs that are consistent with the current status of retail competition in NJNG's service territory.

At the same time as these discussions have been underway, the Board Staff has convened a Gas Policy Group as directed by the Board[3] for all interested parties to consider the long-term structure of BGSS including pricing and reliability issues. The

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[2] See Board Order in Docket No. GX01050304, dated January 17, 2002 at page 4.

[3] See Board Order in Docket No. GX01050304, dated January 17, 2002.

outcome of these discussions may provide new opportunities to design future incentive mechanisms that further the State's policy goals.

Additional time beyond December 31, 2002 is needed for NJNG and interested parties to develop an appropriate package of incentive mechanisms for the future and to prepare adequate documentation for the Board's review. Ideally, the incentive program would support any modifications to the general levelized BGSS pricing methodology that is in place today. Given the current status of the discussions of NJNG's incentive mechanisms, NJNG, the Board Staff and the Ratepayer Advocate agree that a 12-month extension of the existing programs is both reasonable and appropriate.

<u>Recommended Extension and Benefits</u>

The existing programs continue to reflect NJNG's ongoing role as BGSS provider to a substantial number of its customers and ensure that these customers receive the benefits they have historically enjoyed.